No. 208. 31

Brf. of Tenney, Flower & Musgrave for Appts

Office Supreme Court U.S.
FILED
JAN 7 1901
JAMES H. McKENNEY,
Clerk.

Filed Jan. 7, 1901.

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1900.

No. 208.

WILSON BROTHERS, et al.,
Appellants,

vs.

CASSIUS B. NELSON,
Appellee.

On a Certificate from the United States Circuit Court of Appeals, for the Seventh Circuit.

BRIEF AND ARGUMENT FOR APPELLANTS.

DANIEL K. TENNEY,
JAMES M. FLOWER,
HARRISON MUSGRAVE,
Attorneys for Appellants.

Geo. Hornstein Co., Printers, Chicago.

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1900.

No. 208.

WILSON BROTHERS, et al., *Appellants,*

vs.

CASSIUS B. NELSON, *Appellee.*

On a Certificate from the United States Circuit Court of Appeals, for the Seventh Circuit.

BRIEF AND ARGUMENT FOR APPELLANTS.

STATEMENT OF FACTS.

December 10, 1898, appellants, as creditors, filed their petition in the District Court of the United States, for the Western District of Wisconsin, asking that Cassius B. Nelson, appellee, be adjudicated a bankrupt. One of the acts of bankruptcy alleged was, that while insolvent, Nelson had suffered or permitted Sarah Johnstone, one of his creditors, to obtain a preference through legal proceedings, by the entry of a judgment against him, and the levy of an execution thereunder upon his stock of goods, he not having vacated or discharged the lien before the sale of the property under the execution. There was a hearing in the District Court upon issues formed on the petition, as amended, and after evidence taken the court (Judge Bunn) refused the adjudication and

dismissed the proceeding. The only opinion rendered was upon a preliminary motion to dismiss the original petition. (*In re Nelson*, 98 F. R., 76.) The questions now under consideration were, however, there passed upon and decided adversely to the petitioners. From the judgment finding that Nelson had not committed an act of bankruptcy, and dismissing the petition, the creditors appealed to the United States Circuit Court of Appeals for the Seventh Circuit, which court, without deciding the case, has certified here three of the questions involved for decision.

The facts as found by the certificate are as follows: February 5, 1885, Nelson, upon sufficient consideration, delivered to Sarah Johnstone, his judgment note for $8,960, payable five years, or before, after date, with interest at 4 per cent. Soon afterwards Nelson entered into business at Madison, Wis., and continued until November 21, 1898, when the Sheriff levied upon his stock of goods under the judgment entered by virtue of the power of attorney in this judgment note. Nelson, on November 1, 1898, and long prior thereto, had been insolvent, as he well knew; but the judgment was entered without his knowledge or consent, and the judgment and levy could have been vacated or discharged only by his filing his voluntary petition in bankruptcy or by the payment of the debt. The goods levied on were sold by the Sheriff under the execution.

The questions certified for the consideration of this court are as follows:

1. Whether the said Cassius B. Nelson, by failure to file his voluntary petition in bankruptcy before the sale under such levy, and to procure thereon an adjudication of bankruptcy, or by his failure to pay and discharge the judgment before the sale under such levy, committed an act of bankruptcy within the meaning of section 3a subdivision (3) of the Bankrupt Act, 30 Stat., Chap. 541.

2. Whether the judgment so entered and the levy of the execution thereon was a preference "suffered" or "permitted" by the said Nelson within the meaning of clause (3) of section 3a, of the Bankrupt Law.

3. Whether the failure of Nelson to vacate and discharge the preference so obtained, if it was one, at least five days before the execution sale, was an act of bankruptcy.

THE PROVISIONS OF THE BANKRUPT ACT OF 1898 BEARING ON THE QUESTIONS CERTIFIED, AND THE CORRESPONDING SECTIONS OF THE LAW OF 1867.

ACT OF 1898.

"Section 3. ACTS OF BANKRUPTCY: (*a*) Acts of bankruptcy by a person shall consist of his having * * * (3) *suffered or permitted,* while insolvent, any creditor to obtain a preference through legal proceedings, and not having, at least five days before a sale or final disposition of any property affected by such preference, vacated or discharged such preference."

"Section 60. PREFERRED CREDITORS: (*a*) A person shall be deemed to have given a preference, if, being insolvent, he has *procured or suffered* a judgment to be entered against himself, in favor of any person, or made a transfer of any of his property, and the *effect* of the enforcement of such judgment or transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class."

"Section 67. LIENS: * * * (*c*) A lien created by, or obtained in, or pursuant to, any suit or proceeding at law, or in equity, including an attachment upon *mesne process, or a judgment by confession* which was begun against a person within four months before the filing of the petition in bankruptcy, by or

against such person, shall be dissolved by the adjudication of such person to be a bankrupt, if (1) it appears that said lien was *obtained and permitted* while the defendant was insolvent, or that its existence and enforcement *will work* a preference, or (2) the party or parties to be benefited thereby, had reasonable cause to believe the defendant was insolvent, and in contemplation of bankruptcy, or (3) that such lien was sought and permitted in fraud of the provision of this act.

"(*f*) That all levies, judgments, attachments or other liens, obtained through legal proceedings against a person who is insolvent, at any time within four months prior to the filing of a petition in bankruptcy against him, shall be deemed null and void, in case he is adjudged a bankrupt."

ACT OF 1867:

"Section 39: INVOLUNTARY BANKRUPTCY: That any person * * * who, being bankrupt, or insolvent, or in contemplation of bankruptcy or insolvency, shall * * * *procure or suffer* his property to be taken on legal process, *with intent to give a preference* to one or more of his creditors, * * * or with the intent by such disposition of his property to defeat or delay the operation of this Act, shall be deemed to have committed an act of bankruptcy."

"Section 35: PREFERENCES AND FRAUDULENT CONVEYANCES DECLARED VOID: That if any person, being insolvent or in contemplation of insolvency, within four months of the filing of the petition by or against him, *with a view to give a preference* to any creditor, or person having a claim against him, or who is under any liability for him, *procures* any part of his property to be attached, sequestered or *seized on execution,* or makes any payment, pledge, assignment, transfer or conveyance of any part of his property,

either directly or indirectly, absolutely or conditionally, the person receiving such payment, pledge, assignment, transfer, or conveyance, or to be benefitted thereby, or by such attachment, payment, pledge, assignment or conveyance, having reasonable cause to believe such person is insolvent, and that such attachment, payment, pledge, assignment or conveyance is made in fraud of the provisions of this Act, the same shall be void."

"Section 29: OF THE BANKRUPT'S DISCHARGE AND ITS EFFECT: That at any time after the expiration of six months from the adjudication of bankruptcy, * * * and within one year from the adjudication of bankruptcy, the bankrupt may apply to the court for a discharge from his debts. * * * No discharge shall be granted if the bankrupt * * * within four months before the commencement of such proceedings, *has procured* his lands, goods, money, or chattels to be attached, sequestered, or *seized on execution*."

BRIEF.

THE FAILURE OF NELSON TO VACATE OR DISCHARGE THE LIEN OF THE EXECUTION FIVE DAYS BEFORE THE SALE THEREUNDER, CONSTITUTED AN ACT OF BANKRUPTCY UNDER SEC. 3 (A), SUB. 3; AND THE THREE QUESTIONS CERTIFIED SHOULD BE ANSWERED IN THE AFFIRMATIVE.

In re Reichman, 91 F. R., 624 (Adams, D. J., Mo. Feb. 17, 1899).

In re Moyer, 93 F. R., 188 (McPherson, D. J., Pa., April 12, 1899).

In re Cliffe, 94 F. R., 354 (McPherson, D. J., Pa., June 2, 1899).

In re Arnold, 94 F. R., 1001 (Evans, D. J., Ky., June 8, 1899).

In re Ferguson, 95 F. R., 429 (Brown, D. J., N. Y., May 16, 1899).

In re Rome Planing Mill, 96 F. R., 812 (Coxe, D. J., N. Y., Oct. 4, 1899).

Parmenter Mfg. Co. v. *Stover,* 97 F. R., 330 (Cir. Ct. of App., 1st Cir., Oct. 25, 1899).

In re Chapman, 99 F. R., 395 (Newman, D. J., Ga., Feb. 8, 1900).

Bear v. *Chase,* 99 F. R., 920 (Cir. Ct. of App., 4th Cir., Feb. 6, 1900).

In re Thomas, 103 F. R., 272 (Buffington, D. J., Pa., July 23, 1900).

In re Storm, 103 F. R., 618 (Thomas, D. J., N. Y., July 27, 1900).

In re Meyers, 1 Am. B. R., 1—1 Natl. B. N., 207 (Hotchkiss, Referee, N. Y., Apr. 1, 1899).

Collier on Bankruptcy, 3d Ed., p. 37.

ARGUMENT.

The learned District Judge said in his opinion in this case (98 F. R., 77), that, "to make the *entry of judgment* an "act of bankruptcy, there should be some fault on his (Nel-"son's) part by way of *procuring* or suffering the act to be "done. The case comes squarely within the decisions of "the Supreme Court in *Wilson* v. *Bank,* 17 Wall., 473, and "*Bank* v. *Warren,* 96 U. S., 539."

The act of bankruptcy complained of is not the *entry of judgment,* but Nelson's failure to *vacate or discharge the execution.* This could have been accomplished in either of two ways, by payment,

or by filing a voluntary petition in bankruptcy. The second method was easily within his power. His failure to use it authorized the court to adjudicate him a bankrupt upon the petition of creditors, and thus avoid the preference. It was not the entry of judgment, but the suffering of the sale under the execution, that established the preference.

The principal object of the act is to secure an *equal* distribution of an insolvent's property among his creditors (*Shawhan* v. *Wherrett*, 7 How., 627; *In re Richards*, 96 F. R., 936); and the act is not to be construed strictly, but liberally to effect this object and promote justice. (*In re Muller*, 3 N. B. Reg., 329; *In re Locke*, 2 N. B. Reg., 382; *In re Silverman*, 4 N. B. Reg., 523.)

The cases cited by Judge Bunn, *Wilson* v. *Bank*, and *Bank* v. *Warren*, are not in point. They were both decided under the law of 1867. They held that something more than passive non-resistance is necessary to establish the prohibited preference. But these decisions rest upon a construction of clauses in the act of 1867 essentially different from those in the Act of 1898. Section 39 of the Act of 1867 provided that any person who, being insolvent, shall "*procure*" or suffer his property to be taken on legal process, "*with intent to give a preference,* * * * shall be "deemed to have committed an act of bankruptcy." The corresponding section (3) in the Act of 1898 provides that an act of bankruptcy shall consist of having "*suffered or permitted,* while insolvent, any creditor to obtain a preference through legal proceedings and not having * * * vacated or discharged the preference." In the former act occurs the word "procure," used by Judge Bunn in his opinion; but in the present act the word is changed to "permit." The Act of 1867 required an "intent to give a preference." This element is entirely absent in the Act of

1898. That this requirement of an intent to prefer in the Act of 1867 was alone responsible for the two decisions referred to seems apparent from the language of Mr. Justice MILLER in *Wilson* v. *Bank*, as follows:

> "Though the main purpose of the 39th section is to define acts of the trader which make him bankrupt, and that of the 25th is to prevent preferences by an insolvent debtor in view of bankruptcy, both of them have the common purpose of making such preference void; and both of them make this to depend *on the intent* with which the act was done by the bankrupt. * * * It is, therefore, very strongly to be inferred that the act of suffering the debtor's property to be taken on legal process in Sec. 39 is precisely the same as procuring it to be attached or seized on execution in Sec. 35. * * * What, then, is the true meaning of that phrase in the act? In both cases it must be accompanied with *an intent*. * * * In both there must be the positive purpose of doing an act forbidden by the statute. The facts before us do not show any positive or affirmative act of the debtor's from which such intent may be inferred."

That it was the intention of Congress to eliminate the question of intent in reference to preferences, and make the effect of the transaction the controlling element, seems clear from an examination of the proceedings of the 55th Congress which passed the present law. Section 40 of the Lindsay Bill (which afterwards became the Henderson Bill), introduced in the Senate March 22, 1897, provided as follows:

"An act of bankruptcy by a person shall consist of his having * * * (5) made, while insolvent, a transfer of any of his property, or suffered any of it to be taken or levied upon, by process of law or otherwise, *for the purpose* of giving a preference; (6) *procured* or suffered a judgment to be entered against him, *with intent* to defeat his creditors."

The Nelson or Senate Bill had no provision for involuntary bankruptcy, but it provided in Section 4 that the bankrupt could not be discharged if within four months prior to filing the petition he had suffered any of his creditors to acquire a preference by legal proceedings. The House Bill and the Senate Bill went to a conference committee which agreed upon the bill substantially as it now exists, and the clause in the House Bill making it an act of bankruptcy if a person shall have "procured or suffered a judgment to be entered "against him, with intent to defeat his creditors," was changed so as to read as it now does in subdivision 3 of Section 3*a*, *i. e.*, the word "procured" and all reference to the intent of the insolvent were eliminated.

That the effect and not the intention of the act is the controlling element is shown also by Section 60, which provides that "a person shall be deemed to have given a preference if, "being insolvent, he has procured *or* suffered a judgment to "be entered against himself * * * and the *effect* of the "enforcement of such judgment * * * will be to enable "any one of his creditors to obtain a greater percentage of his "debt than any other of such creditors of the same class." Section 60 of the Henderson Bill (Cong. Rec., 55th Congress, p. 2042), for which this section is a substitute, made the *intent* of the insolvent essential to create a preference. Although the word "procured" occurs in Section 60 of the present law, it is separated by the disjunctive "or" from the word "suffered," and when we take this section as a whole it is apparent that the word was not used for the purpose of requiring any affirmative act or intent on the part of the insolvent as a necessary element of the preference. (*In re Meyers, supra.*)

That the question of intent has been purposely eliminated from the present act also appears from Section 67*c*, which

provides that a lien created under a judgment by confession or other legal proceedings, obtained within four months before filing the petition in bankruptcy, shall be dissolved by the adjudication of the debtor to be a bankrupt, if "it appears that said lien was obtained and permitted while the "defendant was insolvent, *or that its existence and enforcement will work a preference.*" Section 67*f* provides "that "all levies, judgments, attachments or other liens obtained "through legal proceedings against a person who is insolvent "at any time within four months prior to the petition in "bankruptcy against him, shall be deemed null and void in "case he is adjudged a bankrupt." These two subdivisions of Section 67 were construed by the Circuit Court of Appeals for the Seventh Circuit (*In re Richards,* 96 F. R., 935), and it was held that all liens obtained through legal proceedings against an insolvent debtor, within four months prior to the filing of a petition in bankruptcy by or against him, are annulled by his adjudication as a bankrupt, irrespective of the question whether the debtor suffered or permitted the lien to be obtained.

It clearly could not have been the intention of Congress to enable the insolvent to destroy the entire effect of Section 67 by simply refraining from filing a voluntary petition in bankruptcy and by suffering his goods to be sold under execution, leaving creditors powerless to take any proceedings in the bankruptcy court to avoid the preference. The learned Judge who wrote the opinion in the *Richards* case said the act "asserts the principle that as between creditors equality "is equity, and that the race of diligence must cease with "respect to legal proceedings against a person who is in-"solvent at the commencement of four months preceding "the filing of the petition." A construction of the act which would permit the diligent creditor to obtain a judgment note

and, after delaying four months, cause judgment to be entered thereunder and a levy made on all the property of the insolvent, and which would prevent creditors from taking action to obtain an adjudication in bankruptcy against the debtor in case he failed to take any steps to avoid the preference, would defeat the manifest object of the law. Insolvents who are about to fail nearly always wish to prefer their relatives or favorite creditors. To acquire a preference under the old law it was only necessary for the insolvent to give a judgment note and permit the creditor to have it entered four months after its date, and levy upon the debtor's property. Such a preference was easily obtained and entirely effectual. This was one of the very things the present law was enacted to prevent. The *giving* of a judgment note does not create a lien or preference. The value of such a note consists in that by virtue of the power of attorney therein the creditor may enter judgment at his will after maturity of the note without the knowledge or consent of the debtor, *i. e.* it enables the creditor to obtain a lien by immediate judgment, and levy of execution. Simply "permitting" or "suffering" the creditor to obtain such lien may not be an act of bankruptcy; but if the insolvent fails to vacate or discharge the lien of the execution at least five days prior to sale thereunder, and thus evinces his purpose to permit the lien to become an established preference, the act of bankruptcy results. It is apparent that if an insolvent actively assists a creditor through legal proceedings to obtain a preference he could not be expected ever to vacate or discharge it. He does not want it discharged. Therefore the words "permitted" and "suffered" can not have reference only to those debtors who actively procure the preference. The only sensible construction of the statute is, that when the affairs of an insolvent reach a point where some creditor

obtains a lien by legal proceedings, the debtor shall have until five days before the sale of the property to vacate the proceeding or discharge the lien by payment or by filing his voluntary petition in bankruptcy. If he be not able or willing to do either of these things his unpreferred creditors may resort to bankruptcy proceedings for the purpose.

In the *Meyers* case, *supra,* the learned referee, with much industry, has collected the provisions of the English and Canadian bankruptcy acts (which have abandoned the debtors' intent as a test), and has shown with great clearness that this clause of the act, so construed, "brings our legislation "on this important subject up to the level of the commercial "civilization of which we are a part."

The decisions in all cases so far decided, except the decision of Judge Bunn in this case, sustain the construction of this section of the statute for which we contend.

The first case decided was *in re Reichman,* 91 F. R., 624, in which an attachment had been levied upon the debtor's stock of goods without any participation on the part of the debtor. The debtor having failed to discharge the attachment lien, was upon petition of creditors, adjudged a bankrupt. The court (Adams, D. J.), without going exhaustively into the question, referred to the statute and said that the language of section 3 (a), subdivision 3, in its ordinary and natural meaning does not contemplate any actual participation or agency of the debtor; that he suffers or permits the act to be done if he allows it to be done or so conducts his business that a creditor has cause for attachment, and actually attaches; that unless the debtor discharges or vacates the attachment within five days before a sale, the act of bankruptcy becomes complete.

In the case of *Moyer,* 93 F. R., 188, a judgment had been entered upon a judgment note, and an execution levied

upon the goods of Moyer. The judgment was entered without his knowledge or consent, but he had no valid defense to the action. Judge McPherson stated that the question was one of importance, and gave it careful consideration. He held that the cases of *Wilson* v. *Bank*, 17 Wall., 473, and *Clark* v. *Iselin*, 21 Wall., 360, were not controlling, as the provisions of the act of 1867 on the subject were essentially different from those of the act of 1898; that the result of the legal proceedings taken against the debtor, and not his intention, was the controlling question; that if no other way to discharge the preference was available the insolvent "has "still at command one sufficient weapon of which he can "not be deprived. He can apply promptly to the court in "bankruptcy and ask that his property shall be ratably "divided among his creditors. If he fails to move, his action "is properly regarded as a confession that he is hopelessly "insolvent and as conclusive proof that he consents to the "preference that he has declined to strike down." The court called attention to the fact that the preference was obtained by the issuing of the execution and not by the giving of the judgment notes.

Judge Coxe, of the Northern District of New York, in the case of *Rome Planing Mill*, 96 F. R., 812, went into this question as a new one and carefully considered it. He held that under this section three things only were necessary to be proved; first, that a preference was obtained by a creditor through legal proceedings; second, that the debtor suffered or permitted the preference and did not vacate or discharge it at least five days before a sale or final disposition of the property affected; third, that the debtor was insolvent at the time the preference was obtained. He said:

> "The debtor's intent is not made an ingredient. It is enough that the creditor has obtained a preference and

that the debtor has permitted it to remain undischarged. What was the debtor's intent regarding the matter is wholly immaterial. It is not necessary that he should do any affimative act. If he remains passive and supine and permits his property to be taken by one creditor at the expense of the others, he has suffered or permitted a preferenc to be obtained."

In the case of *Parmenter Mfg. Co.* v. *Stoever*, 97 F. R., 330, the question was considered by Justices Holt, Putnam and Webb, of the Circuit Court of Appeals for the First Circuit. The case was one where the property of a corporation had been levied upon under an attachment writ. The point was raised that as the insolvent was a corporation and could not file a voluntary petition in bankruptcy, and thus defeat legal proceedings, it could not be said to have suffered or permitted the preference that ensued from them. The court said:

> "Regard, however, must be had to the whole of clause 3; and in view of that, what the appellant 'suffered' or 'permitted' was the sale of its property through legal proceedings. This was clearly the true act of bankruptcy within the contemplation of the statute, although the statute is somewhat awkwardly expressed."

In the case of *Thomas*, 103 F. R., 272, there were judgments entered upon judgment notes and levies thereunder upon the property of the insolvent. A petition for an adjudication in bankruptcy was filed alleging that the debtor had taken no steps to vacate or discharge the executions. On issue joined the commissioner to whom the case had been referred, reported that the executions were valid liens and the petition should be dismissed. The judgments were entered without the knowledge of the debtor. Judge Buffington overruled the commissioner, and held that the preference consisted not in the entry of the judgment, but the levy of the execution. He said:

> "Did the defendant, within the meaning of the Bankrupt Act, thereby suffer or permit a preference through legal proceedings? It is true she took no active affirmative steps to create such preference other than the failure to meet the matured judgment note or provide for its extension; but inasmuch as she took no steps to prevent the enforcement, by sale, of such preference, she must be held to have suffered or permitted these creditors to obtain preference."

The learned Judge then discusses the meaning of the words "permit" and "suffer," and the difference between these words and "procure," citing the case of *Gore* v. *Lloyd*, 12 Mees. & W., 497, and concludes that to permit or suffer implies no affirmative act, involves no intent. It is mere passivity, indifference, abstaining from preventive action. The court then refers to the difference between the present act and that of 1867, and says:

> "In conclusion, we may say, if judicial construction shall inject into this subdivision the element of intent which Congress must have purposely left out,—if it shall require the element of active participation and positive acts on the debtor's part, when Congress has said the negative, non-active passiveness of the debtor is the test,—then assuredly courts, rather than Congress, will in fact enact a bankrupt law. Moreover, if such be the construction, the practical result would be that an insolvent debtor has it in his power, by masterly inactivity,—by abstaining from filing a voluntary petition—to prefer his favored creditors, and, as a practical result, to permit a sale of his property within a few days, and its purchase by such creditors at a sacrifice price."

The other cases cited in our brief are practically to the same effect, although some of them bear upon the construction of other sections of the act.

To summarize: The prime object of the Bankrupt Law, from the standpoint of the creditor, is the avoidance of preferences and the equal distribution of the assets of insolvents under the protection of the bankruptcy courts and the uniform provisions of the act; from the standpoint of the debtor, the discharge of the honest bankrupt. Its purpose is to prevent all preferences after insolvency. The act does not contemplate that a creditor—diligent or favored—may obtain a lien, which the insolvent by his inaction may suffer to become an established preference. If so, the chief object of the law could be easily defeated. It may be asked: If a judgment be entered and levy made without the consent of the insolvent, where is he at fault, what act has he committed or suffered, what can he do? The answer is given by the cases cited. He should not permit his financial affairs to get in such a condition as to induce a creditor to enter judgment and to levy. If the levy be made, he should pay the debt; or make an arrangement with the creditor for an extension; or appeal to his other creditors for assistance. If none of these be possible or effective, he should voluntarily apply to the court of bankruptcy to take charge of his property and make an equitable and equal distribution. If he does not do this, what is the necessary conclusion? He "suffers or permits" the preference. When one is ill, though he may not have been responsible for the illness, he seeks a remedy. If not, and his disease be curable, he voluntarily endures, suffers, permits it. If Nelson had come upon this creditor in the act of breaking open and robbing his safe, and had looked on without preventing it, or calling for assistance, would he not have "suffered and permitted" the robbery? So, here, he stood by, saw this levy, advertisement and sale, and took no step to avoid this wrongful (in the eye of the Bankrupt Law) appropriation of his property.

Nelson committed an act of bankruptcy by suffering his property to be sold under execution, thus permitting Johnstone to obtain a preference through legal proceedings.

It is respectfully submitted that the three questions certified should be answered in the affirmative.

DANIEL K. TENNEY,
JAMES M. FLOWER,
HARRISON MUSGRAVE,
Attorneys for Appellant.

DECEMBER, 1900.